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No. 308

# Supreme Court of the United States

OCTOBER TERM, 1968

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JAMES J. RITTER, *Petitioner*,

*v.*

THE UNITED STATES, *Respondent*.

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

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## PETITIONER'S REPLY BRIEF

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The Government's memorandum confirms that this case squarely presents the purely legal question whether non-compensatory reimbursement for expenses and loss in a required job transfer is taxable to an employee as ordinary income. It concedes that a direct conflict exists between the lower court and decisions of the Tax Court on the expense issue and, significantly, makes no effort to discount the petition's detailed showing (pp. 13-18) that the question presented is of great practical importance and affects annually hundreds

of thousands of taxpayers.[1] Instead, the thrust of the opposition to certiorari is a premature, and unpersuasive, attempt to show that the Government is right on the merits.

In arguing that reimbursements must be included in gross income, the Government first invokes the broad definition of gross income set forth in *Commissioner* v. *Smith*, 324 U.S. 177, 181 (1945), together with supporting authorities. But that definition is explicitly limited (Mem., p. 4) to economic benefits conferred on employees "as compensation" and the uncontradicted showing in the petition (p. 7) is that neither in this case, nor in Federal employment or industry at large, is the reimbursement here involved viewed as "compensatory." On this crucial point, the Government makes no effort to refute this showing or establish that such reimbursements are intended to be, or do in fact operate as, compensation.

The memorandum then cites section 62(a)(2)(A) which in defining adjusted gross income allows deduction of reimbursed business expenses under certain circumstances. The Government's claim is that the present reimbursements are includible in gross income because Congress would not contemplate deduction if an item could be excluded from income in the first place. It is entirely clear, however, that the potential deductibility of a reimbursed expense item does not

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[1] The full formulation of the Tax Court's views on the expense issue is found in Homer H. Starr, 46 T.C. 743 (1966), which took into account and rejected the circuit court holdings relied on by the Government (Mem., p. 4). The Tenth Circuit, despite its earlier decision in the Government's favor, has now held the appeal in *Starr* under advisement for over a year, possibly awaiting disposition of the present test case by this Court.

imply that the reimbursement had to constitute gross income. For example, section 217(e) plainly states that a moving expense item otherwise deductible is not allowed when reimbursement for it "is not included in [the taxpayer's] gross income." In fact, the Government's own admitted exclusion of direct moving expense reimbursements from gross income, expense items alternatively deductible under section 217 in most instances, demonstrates that contrary to the Government's claim a reimbursement need not be gross income even though a deduction be allowed if it is returned as income.

The petition's point, that Ritter realized no net gain and therefore no income on the reimbursements because they merely alleviated employer-caused loss and expenses, is met by the contention that quite apart from any question of gain the expenses were "personal" and not deductible under section 262. This makeweight suggestion that exclusion of reimbursement for such expenses would circumvent the prohibition of that section is belied by the Service's own determination in Rev. Rul. 54-429, 1954-2 C.B. 53, applied and defended by the Government in this very case (Mem., p. 7). That ruling, despite section 262, excludes from income reimbursement for the expenses of transporting "personal belongings" and meals and lodging en route (Mem., p. 7). Whether an item is personal or not depends, of course, upon context, as the varying deductibility of educational and entertainment expenses confirms and the lower court here admitted (Pet., p. 11a). In any event, the argument for excluding the present reimbursements from gross income as non-compensatory payments working no net gain is wholly independent of the alternative claim that the expendi-

tures themselves are deductible. See *Homer H. Starr*, 46 T.C. 743, 745 (1966).[2]

The memorandum in opposition next attempts to reconcile the inclusion of the present reimbursements in gross income with Rev. Rul. 54-429's exclusion from income of so-called direct moving expense reimbursements. 1954-2 C.B. 53. The distinction is defended as a rule of practical administration that in this complex area is entitled to respect. This generality may warrant some discretion to choose between various tenable interpretations of a statute, but it hardly frees the Service to select a purely verbal distinction between direct and indirect expenses that are equally personal or not, equally occasioned by the employer's needs, and equally related to the employee's required relocation. Petitioner submits that this Court's decisions on gross income make it clear that the guiding consideration must be whether a payment effects compensatory gain, and a rule of practical administration must be an expression of the law and not an exception to it. Indeed, the crucial significance of the compensatory element in determining the income tax significance of reimbursements to employees has been recognized by the Service in administering section 119, governing meals and lodging provided by an employer. Within the last month the Service in interpreting this analo-

[2] Since deductibility is an alternative contention not discussed at length by the Government, it is necessary in this reply only to add that the Government's citation of supporting authority on this point must be balanced against the views of a number of disagreeing judges. *E.g.*, Judges Davis and Skelton's opinions in this case (Pet., pp. 18a-20a); Mendel v. Commissioner, 41 T.C. 32 (1963), rev'd, 351 F.2d 580 (4th Cir. 1965); England v. United States, 226 F. Supp. 762 (S.D. Ill. 1964), rev'd, 345 F.2d 414 (7th Cir. 1965), cert. denied, 382 U.S. 986 (1966).

gous Code provision has acknowledged that a criterion of exclusion is whether the benefits were made in the pursuit of "a substantial noncompensatory business reason." Rev. Rul. 68-354, 1968 I.R.B. No. 28, at 7.

No effort is made to relate the direct-indirect distinction to the compensation yardstick, or indeed to furnish it with any rational explanation. The memorandum does assert that Congress in enacting section 217 must have recognized a rational basis for distinguishing between direct and indirect moving expenses. That assertion is far wide of the mark: Congress was concerned only with eliminating the disparity in treatment between (a) employees whose reimbursements the Service excludes from income and (b) employees who were not reimbursed and were denied a deduction by the Service (Pet., p. 17). Not only did Congress decline to sanction the Service's direct-indirect distinction but both the House and Senate Committees expressly stated that the scope of the gross income concept as applied to move-related reimbursements was left for "judicial interpretation" (Pet., p. 17).

Finally, the attempt in the memorandum to pass off the petitioner's house loss reimbursement as governed by the stock option ruling in *Commissioner* v. *LoBue,* 351 U.S. 243 (1956), rests on the wholly false factual premise that no loss was suffered on the house sale. At trial the Government argued and vigorously attempted to prove that the house loss guarantee was "rigged" to provide Ritter with supplementary income. It failed not for want of effort but solely because the facts did not support its thesis. The court below found the appraisers to be honest and objective and the appraisal to have been made "in a reasonable and

objective manner" designed to elicit fair market value (Pet., pp. 13a-16a, 30a, 36a).[3] On the settled record, therefore, the Government cannot now argue that the appraisal was inflated above fair market value and thus cannot establish a parallel to the *LoBue* transfer of property at other than its true worth.

The Government's claim on the house loss reimbursement is without merit even if it were not untimely. Absent other evidence, it may be just to "presume" (Mem., p. 9) that fair market value is proved by the price one had to settle for. But here such a presumption is rebutted both by the evidence of independent appraisers and by the settled fact that the sale was not between "willing" parties but by a transferred employee under a business compulsion to dispose of his house. Certainly no one familiar with real estate would contend that a piece of expensive residential property can be dropped on the market at will with the sure expectation of a fair return. Contrary to the Government's simplistic argument, petitioner's sale was indeed "forced" in the most realistic sense. After six months of fruitless efforts to sell, anyone not compelled to transfer by his employer and not protected by a promise of loss reimbursement might well have awaited a better offer or taken the house off the market. This option was not open to Ritter because

[3] The final appraisal figure was within eleven hundred dollars of the petitioner's cost on his residence, purchased only a year and a half before its sale (Pet., p. 37a), and could reasonably have been higher since petitioner "contributed substantially" himself to the completion of the house (Pet., p. 37a) over and above this cost. Were the price realized accepted as the measure of fair value, petitioner's property would have *declined* almost four thousand dollars below cost during this short period despite the substantial contribution of petitioner and the established trend of increasing values in real estate.

he was required to move to Southern California solely for the convenience of his employer.

To summarize, the Government by its silence virtually concedes that the present case squarely presents a question of continuing importance to hundreds of thousands of middle-income taxpayers on which there is a conflict in the lower courts. In addition, the question is one on which Congress has declined to legislate pending an authoritative interpretation by the courts. These circumstances would warrant certiorari by accepted standards even if the Government appeared to have a strong case to make upon plenary review. It is clear, however, that in taxing reimbursements of the kind involved here the Service has seriously diverged from the compensation test of gross income enunciated by this Court and has adopted an arbitrary formula as a matter of administrative fiat. Accordingly, the merits provide no refuge for the Government but on the contrary furnish a supplementary reason for review by this Court.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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